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The Disappointing Performance of Foreign Direct Investment in Industrial Development in Sub-Saharan African Countries

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ABSTRACT

The Sub-Saharan African (SSA) region compared to other developing regions has been the most vulnerable as regards foreign capital inflow. The flow of foreign direct investment (FDI) is expected to result into advanced managerial and technological capacities and acceleration of industrial development. The study examined how the flow of FDI to the SSA region has impacted the industrial development of the region, using the proxy of industry value added growth. The study made use of pooled data from thirty three SSA countries within the period 1993 and 2012. The method of analysis utilized for the study was the fixed effect least-square dummy variable model, employed to estimate the impact of FDI on industrial development for the selected host countries. The study finds that FDI is statistically significant in relation to industrial development for host SSA countries; but it is disappointing that the expected desired features of industrial development, like increased manufacturing outputs, reduction in high level of import and manufactured goods; etc., have not been realized. It is therefore recommended that the governments of host countries should put policies in place to encourage development of industries domestically, to enhance sustained industrial development, such that dependence on external financial assistance and borrowing could be reduced, resulting in sustained increases in non-oil export earnings, domestic income, savings, investment, technology, and hence improved living standard.

Keywords: Foreign Direct Investment, Industrial Development, Sub-Saharan African Countries
JEL Classifications: F21, O14

1. INTRODUCTION

The flow of foreign investment into developing countries is expected to close the gaps of savings, investment and foreign exchange. Normally, such flows as foreign direct investment (FDI) flows into the domestic sector should improve industrialization, increase production of goods locally and hence reduce the degree of importation of finished goods, while it increases the consumption of locally produced goods. This is so because it is expected that FDI brings with it foreign skills and technology to reduce the skill limitation by technology diffusion as investment reduces savings and foreign exchange constraints. The main objective of the study is to examine the flow of foreign investment into the sub-Saharan African (SSA) region with a view to determine the impact it has on industrial development in the region.

Chenery and Strout (1966) identified three development stages in which growth proceeds at the highest rate permitted by the most limiting factors; the skill limit, savings gap, and the foreign exchange gap. At the early development stages, growth is likely to be investment limited as experienced by most developing economies. It is expected that foreign skill and technology reduce skill limit, investment reduces savings limit and foreign exchange limit equally. Since these gaps constraint development, their removal should brighten development prospects.

The direction of flow of FDI and sector of investment are vital determinants, of the impact that FDI flow has in improving the industrial performance and productive investment of host economies. Despite the relative increase of FDI inflow to Africa, the expected performance in the development of domestic sector, capital formation and industrial performance has failed to materialize. As a result, the desired improved performance in industrialization in the host economies is not achieved, which makes the desired industrial development doubtful and hence making the anticipated increase in total output lacking. This was